CHAPTER EIGHT

Investor Relations

As companies strive to maximize shareholder value, they must continually communicate their progress toward that goal to the investing public. Accordingly, investor relations is an essential subfunction of a company's corporate communication program. While explaining financial results and giving guidance on future earnings are critical investor relations activities, companies today need to go "beyond the numbers"—as Collins and Porras explain in their book *Built to Last*:

> Visionary companies pursue a cluster of objectives, of which making money is only one—and not necessarily the primary one. Yes, they seek profits, but they're equally guided by a core ideology—core values and sense of purpose beyond just making money. Yet, paradoxically, the visionary companies make more money than the more purely profit-driven comparison companies.[1]

Investor relations professionals therefore need to link communications to a company's strategy and "vision" as frequently as possible. Increasingly, the investor relations (IR) function is getting involved in activities traditionally handled by public relations and media relations professionals and communicating with many of the same constituencies. In addition to a solid understanding of finance, IR professionals, therefore, also need strong communication skills.

In this chapter, we begin our examination of this important subfunction with an overview of investor relations and a brief look at its evolution over the years. We then turn to the goals of investor relations and provide a framework for IR. After discussing important investor constituency groups and how IR reaches them, we look at how the function fits into an organization and conclude with a discussion of investor relations in the changing business environment.

Investor Relations Overview

The National Investor Relations Institute (NIRI) defines investor relations as "a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuation."[2] Many practitioners and academics emphasize that "the modern day

[1] James C. Collins and Jerry I. Porras, *Built to Last* (New York: Harper Business, 2002), p. 8.

[2] NIRI corporate website, www.niri.org.

investor relations professional realize[s] that investors are not interested in seeing a company's 10K or 10Q, but instead are interested in understanding the company's business and its value. To create this better understanding, companies have to expand their communications with shareholders from obligatory financial disclosure to include . . . intangible and non-financial aspects of business."[3]

As these descriptions illustrate, investor relations is both a financial discipline and a corporate communication function. Changes in the business and regulatory environment over the past decade have affected the way corporations decide how, to whom, and to what extent they convey financial and operating results.

Investors want understandable explanations of financial performance as well as nonfinancial information about companies. A popular study from Ernst & Young's Center for Business Innovation reveals that analysts and investors rely on a broad range of nonfinancial indicators when making investment decisions, including quality of employees, innovation, the credibility of management, and the execution of corporate strategy.[4] Indeed, according to consulting firm McKinsey, best-in-class companies look beyond basic financial reporting, recognizing that maintaining good communications with analysts and investors involves "shift[ing] focus away from short-term performance and toward the drivers of long-term company health as well as their expectations of future business conditions and their long-range goals."[5]

To ensure that a company presents itself clearly and favorably on all these fronts, then, IR professionals must have both financial acumen and solid communication skills. Access to senior management is also necessary so that the IR function is connected to the company's strategy and vision. An IR department organized in this way is positioned to instill confidence in investors in both good times and bad.

The Evolution of Investor Relations

In the early part of the twentieth century, corporate secrecy was a great concern for companies. Disclosure of any kind was seen as potentially harmful to the interests of the corporation. This perception changed in the 1930s with the passage of two federal securities acts that required public companies to file periodic disclosures with the U.S. Securities and Exchange Commission (SEC). Despite the new reporting responsibilities brought about by the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934, corporations were interested only in mandatory disclosure, which required little in the way of an investor relations function.

Investor relations did not begin to resemble the discipline we know today until the 1950s. A decade later, the National Investor Relations Institute (NIRI) officially recognized the IR function. NIRI was established as a professional association of corporate officers and investor relations consultants who were responsible for communicating with corporate management, the investing public, and the financial community. Around the same time, the Chicago-based Financial Relations Board (FRB), now a unit of The Interpublic Group, became the first public relations firm dedicated to helping its clients develop relationships with investors.

[3] Institute for PR, "Investor Relations," www.instituteforpr.org/investor-relations/, January 2011.

[4] "Measures that Matter," Ernst & Young Center for Business Innovation, May 2010.

[5] Peggy Hsieh, Timothy Koller, and S.R. Rajan, "The Misguided Practice of Earnings Guidance," *McKinsey Quarterly*, May 2006.

By the 1970s, FRB had pioneered the distribution of investment profiles that laid out a company's long-term financial goals and strategies. Prior to this innovation, information reached potential investors through presentations by company representatives to local stockbroker clubs or analysts' societies.

Further regulatory changes altered the landscape for IR in the 1970s. With the enactment of the Employee Retirement Income Security Act (ERISA) in 1974, pension fund managers were legally held responsible for acting in the best interests of their beneficiaries. This new responsibility made pension fund managers more demanding of their portfolio companies. For instance, they sought more detailed explanations of company results, particularly when companies underperformed.

In the 1980s, state and local laws enabled pension funds to increase the equity allocation in their portfolios. That share rose to 36 percent in 1989 from 22 percent in 1982, making institutional investors an even more important constituency for the IR departments of corporations. At the same time, inflation caused many individual investors to flee the stock market, and by the end of the 1980s, institutional investors represented 85 percent of all public trading volume.

The first conference calls were held for hundreds of institutional investors at a time in the 1980s. Soon thereafter, quarterly conference calls were standard practice at many companies. A decade later, the Internet provided yet another channel for communicating company financials to large numbers of investors. Organizations began to create investor relations areas within their corporate websites to post information such as news releases, annual reports, 10-Ks (SEC required annual filing) and 10-Qs (SEC required quarterly filing), and stock charts. Today, the Internet is one of the most important channels for IR. The Internet is unparalleled in terms of cost, speed, and reach, and continues to grow in importance. Companies are using interactive online charts, downloadable data, webcasts, and even apps to communicate their information in new ways. In 2011, Microsoft won the IR Magazine Award for the best investor relations website.[6] Microsoft's website included a visual interactive annual report, videos from recent events, blog posts, interactive and detailed financial data that could be downloaded to Excel, and a constantly updated stream of news.[7]

Even with mass communications such as conference calls and webcasts, however, IR professionals still arranged for periodic private meetings between large institutional investors or sell-side analysts with the chief financial officer (CFO) or the chief executive officer (CEO). These meetings allowed the analysts to ask specific questions and get management's feedback on their own earnings models and projections.

These practices changed with the enactment of legislation designed to put individual investors on a level playing field with large institutions. The 1990s saw a resurgence of individual investor participation in the stock market and, at the same time, deepening concerns that these individual players were not afforded the same access to company information as their institutional counterparts. This

[6] "IR Magazine US Awards 2011," *Inside Investor Relations*, March 24, 2011, www.insideinvestorrelations.com/events/2011/ir-magazine-us-awards-2011/.

[7] Microsoft corporate website, www.microsoft.com/investor/default.aspx.

theory was supported when two studies showed that volatility and trading increased immediately after quarterly conference calls (which were only open to institutional investors).[8]

In response, in late 2000, the SEC passed Regulation Fair Disclosure, commonly referred to as "Reg. FD," prohibiting companies from disclosing "material nonpublic information" to the investment community (e.g., institutional investors, analysts) that has not already been disclosed to the general public. One of the immediate effects of this legislation was the opening up of conference calls to *all* investors, inviting individuals into a previously closed forum that allowed them to hear about company results and strategy directly from senior management. Generally, it set a more formal and coordinated tone for guidance—companies could no longer give "selective guidance"; that is, they could no longer provide some investors with information on earnings projections before others. Some of the other implications of Reg. FD for IR are discussed later in this chapter.

Over the last 50 years, IR has gained the respect and attention of senior management, who increasingly acknowledge it as a vital corporate communications function. The majority of the largest publicly held corporations in the United States and a growing number of small and mid-sized companies are now members of NIRI; by 2011, NIRI had more than 3,300 members representing 1,600 publicly held companies and $9 trillion in stock market capitalization.[9]

Beginning in mid-2007, investor relations became an even more prominent force in business, both for the United States and, as globalization continued to break down borders, the global economy. A global recession, kick-started in part by the subprime mortgage crisis, prompted markets in North America, Europe, and Asia to sink at alarming rates. The turbulence that began in the United States quickly spread around the world, throwing investors and financial analysts into a frenzy. Equity markets both in the United States and abroad tumbled; in January 2008, world equity markets suffered a $5.2 trillion loss, according to Standard & Poor's.[10]

What became known as the Great Recession lasted 17 months, from October 2007 through March 2009, with the S&P 500's total loss reaching 56.4 percent. In February 2007, the market had fallen to its lowest level since 1997.[11] Less than a decade later, the memory of the recession continues to have implications for business executives. Investor relations is all the more important as local markets shift and merge into a global economy and as increased globalization enables one country's recession to initiate a domino effect around the world. Given that investors today demand more communication, more transparency, and more access to companies than they have in the past, corporations competing for their

[8] Steve Davidson, "Understanding the SEC's New Regulation FD," *Community Banker*, March 2001, pp. 40–42.

[9] National Investor Relations Institute website, www.niri.org/FunctionalMenu/About.aspx.

[10] "World Equity Markets Lost $5.2 Trillion in January," February 8, 2008, http://money.cnn.com/2008/02/08/news/economy/world_markets/.

[11] "11 Historic Bear Markets," MSNBC, www.msnbc.msn.com/id/37740147/ns/business-stocks_and_economy/t/historic-bear-markets/#.TxXfh6US2Hc.

investment dollars need to create IR programs that deliver on these requirements. In the next section, we explore how organizations can accomplish this.

A Framework for Managing Investor Relations

How do companies attract and retain investors? When you consider that annual turnover velocity (defined as share turnover in $/market capitalization) was 80 percent on the New York Stock Exchange in 2013, you begin to appreciate the challenges facing investor relations officers (IROs).[12] The following section addresses the key objectives of investor relations and also provides a framework for the implementation of a successful IR program.

The Objectives of Investor Relations

Although the structure of an investor relations program will vary from one organization to the next based on the size of the company, the complexity of its businesses, and the composition of its shareholder base, the main goal of any IR program is the same: to position the company to compete effectively for investors' capital. To achieve this goal, companies need to focus on the following objectives:

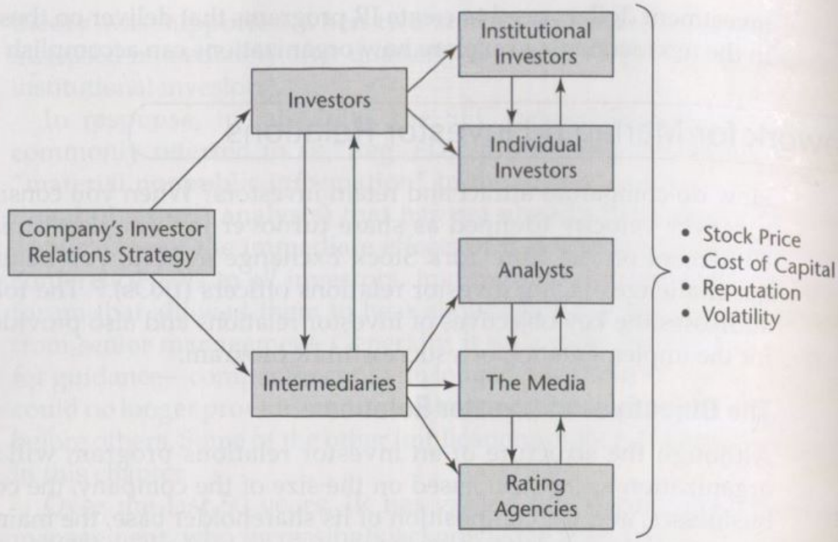
1. *Explain the company's vision, strategy, and potential to investors and intermediaries such as analysts and the media.* One of the most critical duties of an IR professional is to get messages about company results and potential future results across as understandably as possible to the investing public. We further examine the various investor constituencies later in this section.
2. *Ensure that expectations of the company's stock price are appropriate for its earnings prospects, the industry outlook, and the economy.* IROs need to understand investor concerns and expectations for their organizations and relay this information to management to develop so that there is a high-level understanding of what the market anticipates from the company. If management does not see the company as being able to meet market expectations, it needs to work with IR to craft a communication plan to explain why and to manage expectations appropriately. Conversely, if management feels that the company's potential is not reflected in its stock price (that the stock is undervalued), an IR strategy should be developed to help investors see that potential and, accordingly, drive the stock to appropriate levels.
3. *Reduce stock price volatility.* Corporate investor relations activity could account for as much as a 25 percent variance in a company's stock price, according to a survey that polled 243 buy-side investment professionals from mutual, pension, and insurance firms; additionally, 82 percent of the survey's respondents believe that good investor relations affects a company's valuation, that "superb" IR is associated with creating a stock price premium of 10 percent, and that "poor" IR is associated with a median stock price discount of 15 percent.[13] This capability can be accomplished through the related goal of optimizing

[12] World Federation of Exchanges website, www.world-exchanges.org/statistics/annual-query-tool.

[13] Holmes Report, "Investment Professionals Believe Communications Adds—or Subtracts—Value," July 2007.

FIGURE 8.1 **Investor Relations Framework.**

Source: Adapted from Markus Will and Anna-Lisa Wolters, "Interdependencies of Financial Communications and Corporate Reputation," *Proceedings of the 5th International Conference on Corporate Reputation, Identity, and Competitiveness*, Paris, France, May 17–19, 2001. p. 14.



the company's shareholder structure to include primarily long-term owners of the stock. Companies with stable share prices typically enjoy a lower cost of capital and thus can issue new equity more economically. In addition to the more strategic goal of stabilizing share price over the long term, IROs often have to respond to market news or events that have the potential to affect stock price negatively in the short term. We cover some examples of this later in this chapter.

Now that we understand what investor relations is designed to accomplish, let's look at how it achieves these objectives. Figure 8.1 depicts how the IR function communicates both directly and indirectly with investors. The indirect communication occurs through intermediaries such as analysts, the media, and rating agencies. Communication with these constituencies influences stock price, volatility, and, in turn, the firm's cost of capital and reputation.

Types of Investors

A company's IR strategy should address both retail investors (individual shareholders) and institutional investors (pension funds, mutual funds, insurance companies, endowment funds, and banks). These constituencies, however, place different demands on the IR department and require the use of different communication channels. For example, individuals often require substantially less detailed information due to their relative lack of sophistication but require more hand-holding with respect to routine matters such as stock split transactions. In addition, compared with individuals, institutions provide companies with access to larger, fairly concentrated pools of capital, affording them greater efficiencies in message delivery and market impact (defined as the combination of trading volume and price movement).

Institutional Investors

At the end of 2010, institutional investors owned 67 percent of the U.S. equity market.[14] The proportion of U.S. equities held by institutional investors has been growing, creating concern among market participants about the impact this may have on market volatility and information asymmetry between individual investors and more sophisticated institutional investors. The latest research suggests, however, that it is not overall ownership by institutions that matters, but the concentration of ownership in particular stocks and the turnover rate.[15] The proportion of the top 1,000 U.S. companies held by institutional investors is at a historic high, but the average period during which such investors hold equity securities has sharply decreased: for the New York Stock Exchange, the period was about seven years in the 1970s and is now only seven to nine months.[16] There is continuing debate about the influence of institutional investors on the volatility of individual stocks and the market as a whole, but the importance of this subset of investors is clear.

IR departments can identify and target multiple categories of institutional investors. For instance, institutions can be broken down into groups based on portfolio turnover (high, moderate, and low) as well as investment styles (e.g., growth, value, income, index). By grouping investors into smaller constituencies with similar characteristics, IROs can efficiently communicate their message to appropriate target audiences. For example, explaining a company's vision and outlook to index investors will yield little benefit because index fund managers do not have the discretion to change portfolio holdings away from index weightings.

IR professionals (or their agencies) can use databases to gather information on institutional stock holdings, turnover rates, and basic portfolio characteristics to identify institutions whose portfolio characteristics closely coincide with their company's price/earnings (P/E) ratio, yield, market capitalization, and industry classification. A company with a low price/book ratio, for instance, might focus on marketing itself to mutual fund managers who specialize in "value" investments. A small company will similarly target small-cap managers and possibly start raising awareness among mid-cap managers if it is approaching a larger capitalization. This kind of research will prevent the company from spending too much time communicating with uninterested investors.

Having identified those institutions whose investing criteria match its characteristics, the company should develop a plan to interest them in investing for the long term. IROs can then reach those institutions in a variety of ways, including day-to-day phone contact and one-on-one meetings with analysts. For meetings with representatives of large, influential institutions the company would like to have a relationship with, the CEO and/or CFO are often involved.

[14] Marshall E. Blume and Donald B. Keim, "Institutional Investors and Stock Market Liquidity: Trends and Relationships," Working Paper, The Wharton School, University of Pennsylvania, August 21, 2012, available at http://finance.wharton .upenn.edu/~keim/research/ ChangingInstitutionPreferences_21Aug2012.pdf, at p. 4.

[15] Ben Heineman Jr. and Stephen Davis, "Are Institutional Investors Part of the Problem or the Solution?" Yale School of Management, October 2011.

[16] "The 2010 Institutional Investment Report: Trends in Asset Allocation and Portfolio Composition," The Conference Board, 2010.

More formal gatherings are another way to access large groups of institutional investors. For example, CEOs often address analyst or brokerage societies, industry conferences, and conferences geared toward particular kinds of organizations (such as small-cap, high-tech firms). Companies also host their own meetings in major financial centers such as New York and Boston and invite institutional investors who either own or might want to buy the company's stock.

Individual Investors

Just over half of all Americans (52 percent) own equities, either individually or through funds.[17] Like institutions, individual investors are not a monolithic constituency group. They may own stock directly or through mutual funds, company stock plans, or 401(k) plans. They may actively trade securities to generate trading profits on an intraday basis, apply "buy-and-hold" strategies to save for retirement, or anything in between.

Compared with institutions, individual investors have smaller account sizes and generate lower trading volume. In addition, as mentioned previously, they tend to require different types of information than institutional investors.

We talked in Chapter 2 about the blurring lines between a company's constituency groups. As an example, individual investors also can be employees of the company whose stock they are investing in, through a 401(k) program, bonus compensation in the form of company stock, or options. Employees read about the financial performance of their own companies in the media and expect to see information that is consistent with what they are hearing internally. Companies thus should be prepared to respond to employees' concerns about depictions of their organization appearing in the press that are inconsistent with management's own messages to them.

Reaching individuals is more difficult than connecting with institutions, as they are more numerous and harder to identify. The channels companies use to communicate with individual investors include direct mail to affinity groups (e.g., current shareholders, employees, customers, suppliers), the brokerage community to promote their stocks with individuals, and visibility generated through the media and advertising (see Chapter 4 for more on financial advertising).

In recent years, digital platforms have proved to be powerful channels for providing investors with real-time information about companies. In 2013, an Investment Company Institute Study found that 92 percent of U.S. households that owned mutual funds had Internet access and that 54 percent went online for investment information.[18]

The Internet is certainly used by institutional investors as well as individuals—portfolio managers and analysts can now use it to quickly and easily obtain baseline information about a company's financials and see up-to-date press releases—but for individuals who do not also have relationships with company IROs or CFOs, it has provided previously unparalleled access to company information. The Internet

[17] Gallup Poll, www.gallup.com/poll/162353/stock-ownership-stays-record-low.aspx.

[18] 2014 *Investment Company Factbook*, Chapter 11, "Characteristics of Mutual Fund Owners," www.icifactbook.org/fb_ch6.html#shareholders.

has begun to mimic the in-person experience once only accessible to large institutional shareholders via technology such as on-demand videos, webcasts, and presentations being available in real time.

Intermediaries

Investors often learn about corporations through sources other than the company itself. In particular, the media and the analyst community are key conduits. Companies provide information to them through conference calls highlighting quarterly achievements, press conferences announcing annual financial results, and face-to-face meetings to discuss company developments and strategy. Reporters and analysts often present management with probing and difficult questions and report the company's responses to the investing public. Accordingly, management should present honest answers and messages that are consistent with what the organization communicates to investors directly.

The Media

We learned in Chapter 6 that the business world increasingly attracts print, television, and online media coverage. Business network news hosts regularly discuss earnings announcements on their programs and often invite equity research analysts to appear and comment on developments within companies they follow.

Media coverage of business can have a dramatic effect on a company's stock price. As an example, in April 2013, the official Twitter account of the Associated Press was hacked and a tweet sent to nearly 2 million followers claiming: "Breaking: Two Explosions in the White House and Barack Obama is Injured." Only 60 seconds later, the Dow began a steep but short-lived dive, dropping 150 points. It took only another two minutes for the news to spread that the tweet was a hoax, but during those 120 seconds, the fake tweet erased $136 billion in equity market value.[19]

For another, more global example, consider South African beer producer SABMiller PLC. The company had long maintained a stellar reputation among investors for its ability to manage acquired brewers in emerging markets. However, a year after taking over Miller Brewing Company in 2002 for $5.6 billion, its stock began to plummet. In an effort to understand the reasons behind this sudden decline, executives enlisted the help of Echo Research to analyze financial media coverage of the company and pinpoint a potential catalyst. Based on Echo's findings, which compared coverage and analyst commentary against SAB's stock movement, the executives gained insight into which journalists and analysts had the most influence over the strength of the stock. Furthermore, the research identified the biggest factor contributing to the stock's demise: Miller's ongoing and consistently poor performance. With this information in its arsenal, SAB executives retooled their communications strategy to restore investor confidence. In the decade since, the

[19] Max Fisher, "Syrian Hackers Claim AP Hack That Tipped Stock Market by $136 Billion," *Washington Post*, April 23, 2013, www.washingtonpost.com/blogs/worldviews/wp/2013/04/23/syrian-hackers-claim-ap-hack-that-tipped-stock-market-by-136-billion-is-it-terrorism/.

stock has consistently been on the rise, tripling in value, demonstrating that media coverage and investor relations are key drivers of financial performance.[20]

Certainly, having a strong media relations function coordinated with the IR department will be beneficial to a firm's investor relations effort by maximizing access to media outlets and ensuring consistency in the messages each group sends to the media.

Additionally, for low-visibility companies looking to attract investors, obtaining the right kind of media coverage can be a critical component of an IR strategy. In response to the rising influence of the financial media, some IR and PR consulting firms offer "financial media relations" programs to help companies target media strategically.

As we discuss in the next section, the media also play an important role in bringing the views of prominent analysts to the investing public, giving a voice to this other very influential intermediary.

Sell-Side Analysts

IR functions target the financial community through "buy-side" and "sell-side" analysts. Buy-side analysts typically work for money management firms (e.g., mutual funds or pension funds) and research companies for their own institutions' investment portfolios. They sometimes use sell-side research in their analysis, but many perform proprietary analysis, including company visits and their own review of company financials. As such, for the purposes of our investor relations framework, buy-side analysts belong in the institutional investor constituency group and are not intermediaries.

Sell-side analysts, however, cover stocks within certain industries and generate detailed research reports that offer "buy," "sell," or "hold" recommendations. This research is then provided to clients of investment banks such as JP Morgan Chase or retail brokerages such as Charles Schwab. Thus, sell-side analysts are intermediaries between a company and existing and potential investors. According to research from UCLA Accounting Professor Michael Brennan, strong IR can increase interest in the company from both investors and sell-side analysts. Brennan's research shows that sell-side analysts are able to positively affect the trading of stocks by improving market liquidity, increasing trading volume, and tempering reaction to news affecting the company.[21]

In the late 1990s and with the crash of the Internet bubble in 2000, sell-side analysts came under fire for continuing to issue "buy" recommendations on severely underperforming stocks. The media raised awareness of the inherent conflicts of interest in the job of a sell-side analyst working for an investment bank. Traditionally, companies covered by a firm's research team were also important banking clients who could take their business elsewhere or cut off the analysts' access to information if offended by an unfavorable rating.

As the Internet economy was thriving and stock prices seemed to be on an unstoppable upward trajectory, many of these sell-side analysts enjoyed

[20] "What Price Reputation?" *BusinessWeek*, July 9, 2007.

[21] Michael Brennan and Claudia Tamarowski, "Investor Relations, Liquidity and Stock Price," *Journal of Applied Corporate Finance* 12, no. 4 (2000).

near-celebrity status. Merrill Lynch entertainment analyst Jessica Reif Cohen could, in her own words, "instantly add—or subtract—billions in market value."[22] As business coverage received increasing attention in the media, these analysts became household names.

This kind of visibility meant that analyst recommendations carried tremendous weight. According to Zacks Investment Research, between 1985 and 2000, stocks that attracted coverage by three or more analysts fared 37 percent better over the ensuing six months than stocks that did not receive the same coverage.[23] However, when that period is viewed from 1996 to 2003, buy recommendations by independent securities firms (those that have no investment banking business) outperformed the buy recommendations issued by analysts at investment banks by an average of 8 percent annually. In the period following the NASDAQ market peak, buy recommendations underperformed by 17 percent annually.[24]

Even when the Internet bubble burst in early 2000, many analysts maintained sky-high valuations on companies whose stocks were simultaneously plummeting to maintain their firm's investment banking relationships with the companies they covered. Investors, who had come to view these analysts as trusted advisors, felt betrayed and misled. Media coverage of these "star analysts" was just as prevalent as it had been in the dot-com heyday, but its angle on the analysts was decidedly changed. A *Vanity Fair* article characterized the group as "superstar analysts who were no longer objective observers of the market: they were insiders with inherent conflicts of interest."[25] Mary Meeker, once dubbed "Queen of the Net," appeared on the cover of *Fortune* magazine in a feature article entitled "Can We Ever Trust Wall St. Again?".[26]

The burst of the bubble ushered in an era of analyst regulation that changed the landscape for communicating with the sell-side analyst community.

In October 2000, the SEC-proposed Regulation Fair Disclosure (Reg. FD) took effect. Previously, corporations had communicated with analysts through many of the same channels they used for institutions. One-on-one meetings or lunches with the CEO or CFO were common. On a day-to-day basis, IR professionals spent a great deal of time on the phone with analysts, going over specific inquiries or providing feedback on their models. Reg. FD sought to eliminate this standard practice of company executives sharing nonpublic information with security analysts by requiring parallel public disclosure of this information. It had been alleged that executives would reveal material financial and operational information to analysts of investment banks with which their companies had business relationships. And as a result of Reg. FD, corporations were no longer free to give specific feedback on analysts' earnings models beyond corrections to factual data—much to the dismay of the analyst community.[27] This correction had long been standard practice and a key mechanism used by analysts in formulating their own estimates for companies.

[22] Nina Munk, "In the Final Analysis," *Vanity Fair*, August 2001, p. 100.

[23] Brett Nelson, "So What's Your Story?" *Forbes*, October 30, 2000, p. 274.

[24] UCLA Anderson School of Management, www.anderson.ucla.edu/x5046.xml.

[25] Robin Londner, "Street Cleaning," *PRWeek*, July 23, 2001, p. 17.

[26] Peter Elkind, "Can We Ever Trust Wall St. Again?" *Fortune*, May 14, 2001, p. 69.

[27] Tommye M. Barnett, "To Speak or Not to Speak," *Oil and Gas Investor*, September 2001, pp. 73–75.

Many companies responded to the new rule by providing their own models to analysts instead of providing specific feedback on models the analysts created.

In April 2003, the Securities and Exchange Commission, the New York Stock Exchange (NYSE), the National Association of Securities Dealers (NASD), and the New York attorney general announced the $1.4 billion Global Analyst Research Settlement with 10 of the largest U.S. investment banks. The Global Settlement was the result of a long investigation by the New York district attorney that found evidence of investment banks inappropriately influencing the work of research analysts. The settlement sought to eliminate the inherent conflicts of interest in the job of a sell-side analyst working for an investment bank. The settlement imposed $1.4 billion in fines and penalties on 10 of the largest U.S. investment banks, mandated structural changes to ensure research and coverage decisions were independent, and prohibited improper interactions between a firm's investment banking and research functions. In particular, analyst compensation could no longer be based directly or indirectly on investment banking revenues, and research analysts were prohibited from participating in investment banking sales efforts, such as pitches and roadshows.[28]

Several changes have occurred in the IR environment post–Reg. FD and the Global Settlement. The strict regulations surrounding research on stocks have made it more difficult and costly for investment firms to maintain research coverage of as many stocks as they used to. Major broker-dealers are concentrating their research on large-capitalization stocks. Forty percent of all NASDAQ-listed companies have two or fewer analysts covering them.[29] As a result of regulation, there are now fewer analysts and therefore fewer channels for public companies to communicate with the investor community.

The settlement also has meant that analyst coverage has become less optimistic. In 2000, at the height of the boom, 95 percent of stocks in the S&P500 had no "sell" ratings, and no stock had more than one sell rating.[30] Since the settlement, however, according to research from Washington University in St. Louis, analysts have become more cautious in issuing forecasts and recommendations.[31] Among investment firms that had both research and investment banking practices, "strong buy" recommendations were made on stocks 37 percent of the time in the period prior to the Global Settlement, versus 21 percent of the time following the settlement; "buy" recommendations were made 40.6 percent of the time before versus 32.2 percent of the time after; and "hold" recommendations, which have traditionally been seen as bad news by the market, were made 19.9 percent before and 43.3 percent after by affiliated analysts.

One certainty is that the relationships between analysts and the companies they cover can be fraught with tension if not handled strategically. Consider the story of Tad LaFountain, a long-time analyst at Wells Fargo Securities, who announced in July 2005 that he was dropping coverage of semiconductor giant Altera Corporation because

[28] SEC Fact Sheet on Global Analyst Research Settlement, www.sec.gov/news/speech/factsheet.htm.

[29] NASDAQ.com stock screening service, www.nasdaq.com/screening/companies-by-industry .aspx?exchange=NASDAQ.

[30] William H. Donaldson, "Speech by SEC Chairman: CFA Institute Annual Conference," Philadelphia, PA, May 8, 2005.

[31] Stephen Taub, "Spitzer Pact Cut Analyst Bias: Study," CFO.com, November 10, 2004.

company management would not take his calls or provide adequate information to analyze the business. According to LaFountain, who had a "sell" rating on the stock, the company objected to his negative opinion. One of 31 analysts covering Altera, LaFountain says he was told by Altera's VP of Investor Relations Scott Wylie and CFO Nathan Sarkisian that "it was not in the shareholder's interest to facilitate" his analysis.[32]

Media coverage of this decision was fast and negative, with many seeing the move as an attempt to manipulate opinion. A few days later, Altera was forced to apologize, saying, "In retrospect, our decision to disengage was in error, and (we) apologize to Mr. LaFountain, our investors and the investment community."[33]

Clearly, analyst reports contain much more than a simple buy or hold recommendation, and despite the recent crisis of confidence in the objectivity of these ratings, other information about companies contained in these reports is often used by institutional investors to help them with their investment decisions. Analysts remain an important intermediary for a company's IR strategy. IROs also should be prepared to communicate strategically with and handle downgrades from analysts with a communication plan.

Rating Agencies

In the United States, examples of rating agencies include McGraw-Hill's Standard & Poor's (S&P), Moody's Investors Service, and Fitch Ratings. These agencies analyze companies in much the same way that buy-side and sell-side analysts do, but with a specific focus on their creditworthiness. The ratings that these agencies assign to a company reflect their assessment of the company's ability to meet its debt obligations. This rating, in turn, determines the company's cost of debt capital (the interest rates at which it borrows).

These agencies make their ratings available to the public through their ratings information desks and published reports. The highest ratings are AAA (S&P, Fitch) and Aaa (Moody's), and the lowest are D (S&P) and C (Moody's), representing companies that are in default of existing loan agreements. Companies rated BBB/Baa or above are considered "investment grade," and those below are considered not investment grade, or "high yield." The more perjorative term *junk bonds* also refers to below-investment-grade bonds. The lower the rating, the higher the agency's assessment of the company's potential to default on its loans, thus making it more expensive for the company to raise capital by issuing debt.

Debt ratings affect more than a firm's cost of capital. Senator Joseph Lieberman, chair of the Senate Committee on Governmental Affairs, put it this way:

> The credit raters hold the key to capital and liquidity, the lifeblood of corporate America and of our capitalist economy. The rating affects a company's ability to borrow money; it affects whether a pension fund or money market fund can invest in a company's bonds; and it affects stock price. The difference between a good rating and a poor rating can mean the difference between success and failure, prosperity and bad fortune.[34]

[32] Gretchen Morgenson, "An Analyst Receives a Time Out from Altera," *The New York Times*, July 27, 2005.

[33] Gretchen Morgenson, "With Apology to an Analyst, Altera Seeks to Repair a Rift," *The New York Times*, July 29, 2005.

[34] Statement by Chair Joseph Lieberman, "Rating the Raters: Enron and the Credit Rating Agencies," U.S. Senate Committee on Governmental Affairs website, March 20, 2002, www.senate.gov/~gov_affairs/032002lieberman.htm.

A recent example of the ripple effects that debt ratings can have on a company is that of the many bond insurance companies that fell victim to the credit crisis, started in large part by 2007's subprime mortgage collapse. Take FGIC Corp.: On January 30, 2008, Fitch Ratings slashed the bond insurer's rating from AAA to AA after its capital shortfall ballooned to $1.3 billion. Ambac Financial Group Inc. was also downgraded after its aborted attempt to raise the $1 billion necessary to satisfy Fitch's requirements. Ambac's stock value alone dropped from a 2007 high of $96.10 (on May 18, 2007) to a 52-week low of $4.50 on January 17, 2008. In February 2008, Berkshire Hathaway Chairman Warren Buffett stepped up to offer backup insurance on up to $800 billion in municipal bonds to help the troubled industry, but in November 2010, Ambac filed for bankruptcy protection under Chapter 11. Ambac emerged from bankruptcy in early 2013, but at its low, the stock was trading at around $0.08 per share.[35]

Credit rating analysts are similar to equity research analysts when it comes to their relationship with a company, with the obvious exception that they will focus a great deal more on the company's debt structure. Additionally, many buy-side and sell-side analysts rely on the research and ratings of credit analysts as a component of their own assessment of the company overall, especially for firms within capital-intensive industries characterized by heavy debt loads.

Credit rating analysts at the major rating agencies came under fire after the 2008 debt crisis for many of the same reasons equity analysts were under fire in 2001. The rating agencies had lost credibility with the investing public due to perceived conflicts of interest and a lack of willingness to downgrade both corporate and sovereign debt until significantly after the crisis hit.[36] The rating agencies were also being blamed and held directly responsible for some of what happened in the credit crisis. As a result, they have been faced with lawsuits, investigations, and much public and media criticism. By early 2012, the Department of Justice was stepping up its investigations as to what role the agencies played in the 2008 financial crisis.[37] Standard & Poor's, in particular, is involved in a potential landmark fraud suit to determine whether the agency inflated evaluations of mortgage-backed securities in the lead up to 2008. Although regulation of these agencies is still in progress, one would expect the agencies to undergo a transformation similar to what equity sell-side research did in the early 2000s.

Developing an Investor Relations Program

Now that we understand who the key investor constituencies are, let's look at how IR functions are structured to communicate with them: in-house, delegated to an agency, or some combination of the two. This section also takes a closer look at some of the activities that make IR such an important function within a company.

[35] http://ir.ambac.com.

[36] "Rating Agencies under Fire, But Big Reform Unlikely," CNBC, May 13, 2010.

[37] "Justice Department Ramps Up Probe into S&P's Ratings During Financial Crisis," Reuters, January 17, 2012.

How (and Where) Does IR Fit into the Organization?

A company's IR function can be structured in a number of ways, from fully in-house to fully outsourced. In-house IR teams are typically small: according to a recent Korn Ferry survey, the average size of a corporate IR department is between one and two people. At smaller organizations, the CFO might handle IR responsibilities directly and use an agency to perform some of the more routine report-writing tasks.[38]

When companies do turn to agencies for assistance, they can choose from agencies that specialize in IR work, such as Kekst & Company, Abernathy MacGregor, and the Financial Relations Board, or full-service PR firms that have strong IR specialty groups, such as Fleishman-Hillard or Burson-Marsteller. Agencies can help with projects and activities across the spectrum of IR, from report-writing and arranging analyst conferences to higher-end services such as bankruptcy and litigation communications, mergers and acquisitions, and initial public offerings. In the last decade agencies also have focused on fully understanding Reg. FD so that they can help companies with their disclosure policies. Reg. FD has a goal of creating an even playing field between institutional and individual investors; however, it also adds a burden to the company to identify and disclose all material information to all constituents at the same time.

The division of responsibilities between what is done in-house versus what is handled by the agency depends on several factors, including the size of the firm and its IR objectives. However it is arranged, the individuals responsible for a company's IR efforts should have access to senior management, including the CEO and CFO. This situation appears to be the case for in-house IR professionals—an overwhelming majority of IROs—82 percent—report directly to the CEO or the CFO.[39]

Given the increasing overlap between IR and areas such as media relations, in some organizations, IR and corporate communications are linked or part of the same group. The advent of Regulation Fair Disclosure also made many companies consider the merits of combining these areas—or at least ensuring that they are closely coordinated—to avoid inadvertent selective disclosure.[40] If companies applaud the idea of a closer partnership between IR and corporate communications, however, it is not yet broadly reflected in corporate structure. According to a recent survey, IROs report directly into a chief communications officer in less than 5 percent of *Fortune* 500 companies.[41]

Using IR to Add Value

As mentioned previously, the investor relations function assumes a marketing role with respect to a company's equity and debt, which involves much more than producing and distributing annual and quarterly reports, responding to shareholder inquiries, and sending information to securities analysts. IR plays both proactive and reactive roles within an organization.

Proactively, IR targets investors to whom they can market the company's shares and provides regular informational updates and explanations of performance to the

[38] Korn Ferry Institute, "The Investor Relations Officer," 2012.

[39] Ibid.

[40] Robin Londner, "IR-PR Link Not Seen in Chain of Command," *PRWeek*, March 4, 2002, p. 3.

[41] Korn Ferry Institute, "The Investor Relations Officer".

Annual Reports: More Than Just the Numbers

The SEC's reporting requirements create the need for a number of documents to be produced periodically, such as the annual report, form 10-K, and form 10-Q. Companies can file these reports electronically with the SEC, and investors can download them from the SEC's online database, EDGAR, or the company's own website in addition to, or instead of, receiving hard copies.

Among all these documents, the annual report is the most time-consuming, expensive, and high-profile endeavor. An annual report is a company's equivalent to a "coffee table piece" and is used by companies as an image vehicle and a reporting tool. Annual reports have played a role in shaping corporate reputation and public perception for decades. An annual report gives a company the opportunity not only to share and explain results for the prior year, but also to communicate the company's vision. Investors can obtain the financial information contained in a printed annual report faster online, yet there is still great demand for the printed piece. The 2012 NIRI annual report reveals that the majority of NIRI members produce both print and electronic versions of their annual report, while 5 percent issue an electronic version exclusively, and 7 percent put out just a printed report.[1]

Annual reports typically have themes that are carried through the piece in graphics and text. Thompson Reuter's highly regarded 2013 annual report had the theme "The World Cannot Wait." The theme emphasized Thompson Reuter's role in helping clients stay ahead of the curve with its global information platforms. The annual report was a dynamic website with downloads, photographs, data, and client stories embedded throughout. The annual report won awards for its report narrative, reporting of financials, information accessibility, and creativity.[2]

Thompson Reuters reflects another prominent theme in annual reports today: the rise of sustainability reporting. Its report was addressed to "Our Shareholders and Stakeholders," emphasizing the importance of multiple stakeholder groups, and included not only the typical sections on strategy, vision, and financials, but also a special report on corporate responsibility. In their 2013 annual reports and 10-Ks, 51 percent of the world's largest companies included CR information.[3] According to KPMG: "[T]he direction of travel is clear and with more than half of companies researched now including CR data in their financial reports, this can arguably be considered as standard global practice."[4]

Today, annual reports are used as reporting vehicles, brand builders, recruiting pieces, marketing brochures, corporate image books, and strategic positioning tools. Even as more companies post their annual reports online in new, innovative ways, it doesn't appear that the hard-copy version will go away.

[1] NIRI Annual Report 2012, www.niri.org/Main-Menu-Category/resource/publications/Executive-Alert/2013-Executive-Alert-Archive/NIRI-Annual-Report-2012-Survey-1413.aspx.

[2] League of American Communications Professionals 2013 Vision Awards, www.lacp.com/2013vision/awards-annual-report-competition-thomson-reuters.htm.

[3] The KPMG Survey of Corporate Responsibility Reporting, 2013.

[4] Ibid.

marketplace. Proactive communications can go beyond traditional analyst calls and include activities such as "field trips" for analysts and portfolio managers. Plant tours and meetings or lunches with key company executives can provide investors and potential investors with a true feel for the company and its management.

IROs also craft communication strategies in response to certain internal or external events. Internal events such as mergers, acquisitions, or the sale of a part of the business allow time to confer with the CEO and CFO, develop a communication strategy around the event, and script answers to anticipated questions and concerns. External events, however, such as an unanticipated crisis (see Chapter 10) require much more rapid damage control.

Charles C. Conaway, former President of the drugstore chain CVS Corp., explained: "Unless you have a very targeted investor-relations program that communicates your message, you're going to get in trouble."[42] CVS underwent a restructuring in 1995 that resulted in a complete turnover of its shareholders in the course of one year. To resolve this instability, CVS bolstered its investor relations program and began actively recruiting longer-term institutional investors to suit its new growth profile.[43] In 2004, CVS won the Interactive Investor Relations Award from the Web Marketing Association.

Companies with extensive IR resources can conduct research to identify their most influential shareholders and seek to understand what motivates them, allowing management to predict more accurately the effect on share price of various events or announcements. Research on the changing stock prices of large U.S. and European public companies over a two-year period showed that a company's share price is significantly influenced by a maximum of 100 current and potential shareholders.[44] By identifying these investors and creating profiles on each of them that detail how they make decisions and what motivates them, companies can better perform scenario analysis on the potential effect on the stock price of certain announcements. If necessary, management can modify plans to bring them in line with the desires of key shareholders and minimize negative effects on stock price.

Management also must be careful, however, not to become beholden to investor demands in the short term. The bull markets of the 1980s and 1990s were a major cause for the short-term orientation of the investment community. As Bain & Company Director Darrell K. Rigby commented at the height of the dot-com boom: "I've seen so many senior executives saying and doing things to deliver short-term news lately that it's a little frightening. . . . Their time horizons are shortening. They're thinking more about retiring rich at 45 or 50 and less about the institution they will leave behind."[45] Perhaps a certain corporate strategy will not deliver the earnings that investors and analysts are expecting in the short term, but if the strategy is one that the company believes is right for the long term, management must clearly explain the reasons for this to the investment community. Indeed, the former CEO of Merck says "CEOs are focusing way too much on maximizing shareholder value and on short-term results."[46]

NIRI's former head, Lou Thompson, maintained that the 19 percent drop in Hewlett-Packard (HP) shares and nearly 10 percent decline in Compaq shares that occurred the day the HP–Compaq merger was announced in 2004 could have been mitigated by stronger IR efforts. If Compaq and HP had identified market skepticism over the merger, Thompson argued, the companies could have addressed these concerns before investors "voted with their feet" and took a toll on both companies' stock prices.[47]

[42] John A. Byrne, "Investor Relations: When Capital Gets Antsy," *BusinessWeek*, September 13, 1999, p. 72.

[43] Ibid.

[44] Kevin P. Coyne and Jonathan W. Witter, "What Makes Your Stock Price Go Up and Down," *McKinsey Quarterly*, no. 2 (2002), p. 28.

[45] Byrne, "Investor Relations."

[46] Raymond V. Gilmartin, "CEOs Need a New Set of Beliefs," Harvard Business Review Blog Network, September 26, 2011.

[47] "Understanding IR," *PRWeek*, September 24, 2004, p. 17.

When a crisis hits, or a company undergoes some structural change that the market reacts to negatively, investors have already lost money as the stock price usually adjusts downward nearly instantaneously. Either shareholders can join in the selling, or they can continue to hold the company's stock, hoping that it will recover. To ensure that shareholders do not sell, companies must be prepared with swift, honest communications to investors when the stock price starts spiraling downward.

Management must identify the problem (or perceived problem), what caused it, and, importantly, develop a strategy to address it. In these types of "damage control" situations, channel choice matters: a webcast or conference call with the CEO or CFO will carry much more weight than a press release posted to the company website.

Similarly, when a company is not performing as well as it should, IR professionals should proactively communicate to analysts and investors what management is doing about the situation. Such candor is definitely in the company's best interests. As Thomas Garbett says:

> Information reduces risk. The stock market, as a process, arrives at a stock price based upon all known elements relating to the company. Some of the unknown factors add to the price, others subtract. Areas about the company that are unknown usually contribute to the minus side of the price equation.[48]

Investor Relations and the Changing Environment

The chapters thus far have referenced the instigators for the dramatically changing business climate, including the rise of digital communications and stakeholder empowerment. Digital platforms, in particular, have prompted the integration of corporate communications subfunctions within the organization, including investor relations. In 2003, NIRI updated its definition of IR to reflect the increasing need for integration; whereas the 1996 definition labeled IR "a marketing activity," the new definition ("a strategic management responsibility that integrates finance, communication, marketing and securities law compliance") is consistent with the theory that the evolving business environment necessitates corporate functions to work cooperatively to manage stakeholder empowerment.[49] While the IR function manages the investor/shareholder and analyst stakeholder groups, the digital communications phenomenon is by no means overlooked. Rather, studies show that shareholders are going online with greater frequency, and shareholder activism has reached new heights as institutional investors look at corporate management with increased scrutiny. The modern IR function leverages these digital channels to reassure shareholders that their brands are financially viable, no matter the business backdrop. A recent

[48] Thomas F. Garbett, *How to Build a Corporation's Identity and Project Its Image* (Lexington, MA Lexington Books, 1988), p. 99. CCBN company website, www.ccbn.com/about/faqs.html (accessed April 11, 2002).

[49] NIRI corporate website, www.niri.org.

Brunswick Study on the investment community's use of digital and social media found that online engagement is increasingly driving investment action.[50] Close to half (49 percent) of investors and analysts read blogs, and nearly one in four respondents had made an investment decision based on a blog post.[51] Almost all of the *Fortune* 500 companies have dedicated investor relations pages that make stock quotes and charts, news releases, webcasts, and company financial statements available to anyone with Internet access. Investors find this kind of instantaneous access to information reassuring, particularly during periods of market volatility and uncertainty. Earnings webcasts also are quite popular. These events enable participants to witness firsthand how companies' top executives handle themselves and can bring an otherwise two-dimensional upper management to life for current and potential investors.

Web-based IR has become increasingly prevalent and is supported by external vendors and agencies that can help companies create effective sites. Jeffrey Parker (who founded First Call) and Robert Adler established Corporate Communications Broadcast Network (CCBN) in 1997, recognizing that "the concept of 'Internet time' has created pressure on corporations to do everything better, cheaper, sooner and faster."[52] Acquired by Thomson Reuters in 2004, the business helped Reuters expand its IR offerings for the corporate communications market. Shareholder .com also emerged in the 1990s to provide an array of online IR services—including website hosting, webcasts, and integrated e-mail. Now owned by NASDAQ, shareholder.com has more than 10,000 corporate clients.[53]

The Internet enables greater transparency by providing nearly real-time information about companies to a wide audience, and this transparency is especially valued in the current business environment. Revised financial reporting guidelines and regulations have set a significantly higher standard for transparency, and investors have begun to watch companies' activities closely and critically. (See Chapter 9 for more information on the Sarbanes-Oxley legislation and the effect it has had on the need for transparency in business.)

Considering that of the 20 largest bankruptcies in history, all but three occurred between 2000–2009, investors have witnessed previously unimaginable corporate events over a short period of time.

America's most admired corporations have felt the ripple effects of investor insecurity. General Electric, for example, saw its shares plummet to $10 in 2009, when its financing subsector, GE Capital, came under fire by the SEC for not offering substantial earnings information to the public, forcing the company to make reporting changes to increase transparency.[54] Shareholder activism has increased

[50] Brunswick Group, "The Investor Community's Use of Digital & Social Media," www.brunswickgroup.com/media/254225/Investor-Survey-Infographic-FINAL.pdf, October 2013.

[51] Q4 Whitepaper, "Public Company Use of Social Media For Investor Relations—Part 4 Corporate Blogs," www.q4blog.com/2012/12/05/q4-whitepaper-public-company-use-of-social-media-for-investor-relations-part-4-corporate-blogs/#sthash.iMhtkHJ3.dpuf, December 2012.

[52] Business/technology editors, "Shareholder.com Clients Showcase Strength at *IR Magazine* U.S. Awards," *Business Wire*, April 3, 2002, Online Lexis-Nexis Academic, April 2002.

[53] NASDAQ.com corporate website.

[54] SEC Complaint against the General Electric Company, www.sec.gov/litigation/complaints/2009/comp21166.pdf.

as corporate management teams face increased public scrutiny of their financial actions. A recent NIRI survey found that more than half of publicly traded companies had activist shareholders—those investors who demand to take an active role in the companies in which they invest—hold their stock. Shareholder activism has exploded alongside the corporate scandals of the past two decades. An analysis of U.S. activism levels in 2012 reveals an overall increase in the number of new campaigns being announced but also an increased willingness on the part of activists to target larger companies.[55]

The current environment, combined with the growth of digital platforms that aid information sharing, means that this particular stakeholder group is becoming increasingly powerful. Time Warner became sharply aware of this reality in 2006 when activist investor Carl Icahn pressed the company to increase shareholder value by dividing itself into four publicly traded companies and buying back $20 billion worth of stock. More recently, Icahn himself has come under fire for insider trading, but his influence remains strong.

As seen from these examples, investor relations is even more important to companies against this backdrop of uncertainty and mistrust. Clear, full disclosure of business results will put companies in a strong position in the competition for investor capital.

Conclusion

Many activities fall under the IR function, from planning and running annual meetings and putting together reports for SEC filings to targeting and marketing the company's shares to investors. These activities should be approached no differently from any other communication activity: companies need to follow a communication strategy that includes a clear understanding of the company's objectives and a thorough analysis of all of its constituencies so that appropriate messages can be crafted and delivered.

Unfortunately, quantifying IR's direct effect on stock price and/or a company's cost of capital is challenging. Today's equity markets are influenced by many factors beyond companies' control, and thus, although it is still used as a broad indicator, stock price does not single-handedly signal an IR success or failure. Anecdotal evidence, however, does provide a basis for the simple conclusion that IR is a required communication function in today's marketplace.

No company can afford to deal with the current investment community without developing an effective investor relations function, whether it is fully in-house, fully contracted to an outside agency, or a combination of the two. The price paid for overlooking this advice is far greater than the investment made in the personnel that staff this important function.

[55] NIRI Boston Activism Shareholder Event, October 2013.

Case 8-1

Steelcase, Inc.

Perry Grueber sat at his desk at Steelcase, Inc., on a bright day in July 2000, thinking about the work that lay ahead for him. Grueber had just joined Steelcase, a maker of office furnishings and workspace solutions, as Director of Investor Relations. Steelcase was dedicated to improving IR at the company and had promised Grueber the resources he required to make the department an effective tool for communicating to key constituencies.

When Grueber accepted his job in May, Steelcase was trading at $11.56 per share, just above its all-time low of $10.38 per share and down 70 percent from a high of $37.94. Steelcase's operating performance was mostly to blame for the declining share price; however, the company's communications with its investors also had played a role. The company had high turnover in its institutional shareholder base and, since the time of its IPO, had not actively marketed itself to sell-side analysts. These analysts, in return, expressed little interest in the company. At the same time, insider sales were increasing, sending more shares into the market amid soft demand. Grueber needed a new IR strategy to help Steelcase turn its situation around. As he settled into his new office at the company's headquarters in Grand Rapids, Michigan, he began to assess the challenge that lay before him objectively.

HISTORY OF STEELCASE, INC.

Steelcase was founded in 1912 by Peter Wege, Henry Idema, and 12 other investors under the name Metal Office Furniture. Wege hoped to capitalize on the benefits of metal furniture over its more flammable wooden counterparts. This original vision found success early on, as government architects began to specify metal in their designs and turned quickly to Metal Office Furniture to fill their demand. Early company successes included the development of the metal wastebasket and the later invention of the suspension cabinet, which became the foundation for all modern filing cabinets.

Company sales in 1913, the first full year of operations, were $76,000. As revenues began to increase, Metal Office Furniture hired a media consultant, who created the trademark Steelcase name in 1921. World War II and the resulting war material contracts benefited the company, and the boom years of the 1950s and 1960s catapulted Steelcase further forward in terms of revenues and profits. By the late 1960s, Steelcase had become the largest manufacturer in the office furniture industry. It retained that status through the year 2001, when the company reported revenues of $4.1 billion.

Steelcase's founder, Peter Wege Sr., died in 1947. Wege's partner Henry Idema died four years later in 1951, and control of the company fell to Henry Idema's son Walter. The Idemas began a tradition of family stewardship over the company that continued when Walter Idema's son-in-law Robert Pew II assumed leadership in 1966. Pew became Executive Chairman in 1974 and retained that title until his retirement in 1999, although James P. Hackett became President and CEO in 1994. By 2000, Steelcase as a company retained the imprint of the vision and the direction it had received through the founding families' descendents.

Source: This case was prepared by Thomas Darling under the supervision of Professor Paul A. Argenti at the Tuck School of Business at Dartmouth. Information was gathered from public and corporate sources, including interviews with Perry Grueber at Steelcase in May 2002.

IDENTITY, VISION, AND REPUTATION

Steelcase built its image from the set of values held by founders Peter Wege and Henry Idema, clearly articulated in its organizational goals: "Steelcase aspires to transform the ways people work ... to help them work more effectively than they ever thought they could."[1] Every employee read the company's core values statement:

"At Steelcase, We:

Act with integrity
Tell the Truth
Keep commitments
Treat people with dignity and respect
Promote positive relationships
Protect the environment
Excel"[2]

Steelcase had a history of "putting people before profits"[3] and dealing fairly with its employees. As Grueber explained, "There is very much a family atmosphere . . . I've never seen a better benefits package and it is not just executive benefits; it's all the way down the line." Tenure with the firm averaged nearly 18 years. The values embodied in Steelcase's treatment of its employees applied to other constituencies as well, including dealers, vendors, and the communities in which Steelcase operated.

As Grueber described it, Steelcase prided itself in "communicat[ing] values through actions. It's not just the corporate line." For example, shortly after becoming CEO, James Hackett voiced his concern that Steelcase's offices did not communicate the company's goal of transforming the way people work to be more effective. Outdated headquarters designs from the 1960s and 1970s isolated executives in their offices. When company management wanted to conduct brainstorming or other creative sessions, they often "fled headquarters."[4]

James Hackett challenged senior management to trade their traditional offices for a new office environment one floor below. This office overcame the existing separation and used a quarter less space. The offer contained an escape clause, allowing management to move back to the traditional offices after a trial period. But the redesigned offices proved to be an unmitigated success, increasing workplace effectiveness and becoming the prototype for a new line of systems furniture called Pathways.[5]

Internally, all members of Steelcase acted in a way that reinforced the company's message of open communication at every level. As Grueber explained, "Executives all have an open-door policy. If you came to visit our offices, you would see that our senior executives reside in an open-plan environment. They don't have enclosed offices and so, we go to great lengths to live our vision."

Externally Steelcase's strong values helped create a dealership network that was the envy of the industry and demonstrated the extent to which Steelcase's values shaped its business. Steelcase relied heavily on its dealers to support its "made to order" business model and made a point of treating them with respect, as primary purchasers of their products and as fellow businesspeople whose own businesses would prosper as Steelcase's had prospered.

THE INITIAL PUBLIC OFFERING

During its time as a private company, Steelcase had developed a much-admired reputation stemming from its well-articulated identity, vision, strategy, and culture. Although Steelcase intended to continue its focus as defined by the original families into the future, the company also believed that it had reached a point where

[1] Steelcase, Inc., website, "Our Company: Overview," http://www.steelcase.com/servlet/OurCompany.

[2] Ibid.

[3] Conversation with Perry Grueber.

[4] Marc Spiegler, "Changing the Game," *Metropolis Feature*, July 1998, http://www.metropolismag.com/html/content/0798/jl98game.htm.

[5] Ibid.

it would benefit from a changeover to public ownership. This change would provide increased liquidity to the company's founding families and give them the ability to diversify their holdings. As the list of Steelcase heirs grew, liquidity became more important to these private owners. Many of the family members wanted to diversify their long-term holdings and allow for distributions to charities and other philanthropic activities. During its 90 years as a private company, Steelcase had grown to become a member of the *Fortune* 500 and the largest manufacturer of office solutions in the United States. By 1998, the private ownership structure for this organization was simply too inflexible.

The economic environment at the end of the 1990s was prime for Steelcase's initial public offering. Data from the Business and Industrial Furniture Manufacturer's Association (BIFMA) forecast double-digit increases in office furniture shipments throughout the first three quarters of 1997.[6] Steelcase was the leader in this growing furniture shipment industry, which was already worth $10 billion in 1996. Furthermore, the U.S. economy overall was still growing at an impressive pace (though the Asian crisis had sparked some doubt in late 1997), white-collar job growth remained strong, and companies were flush with cash from the booming stock market.

Steelcase came to market on February 18, 1998, with a 9.4-million-share offering priced at $28 per share; the proceeds went entirely to family stakeholders. The offering proved very popular with money managers and was oversubscribed to such a degree that the number of shares was increased from 9.4 million to 12.5 million and the IPO price quickly exceeded the originally projected range of $23–$26 per share. On the first day of trading, Steelcase shares rose from the opening offer to close at $33.63, up approximately 20 percent.

[6] Mahua Dutta, "Steelcase Builds IPO," *IPO Reporter*, February 16, 1998.

After the IPO, 156 million total shares were outstanding, with 12.5 million in public hands, and the balance owned by the founding family. Employees received a gift of 10 shares each and options allowing them to purchase shares at below-market rates. One-third of the IPO shares went to employees. Institutions were the largest purchasers of the 12.5 million shares sold to the public.

STEELCASE AS A PUBLIC COMPANY (IPO TO JUNE 2000)

Steelcase hit an all-time closing high of $37.94 per share on March 13, 1998, less than one month after the IPO. Almost everything that followed with respect to the company's stock price, however, was disappointing. Uncertainty caused by the 1997 Asian crisis and the 1998 Russian default significantly disturbed many companies' capital expenditures. In addition, as the year 2000 approached and "Y2K" fears loomed, corporate spending was focused almost solely on technology and information systems. Although traditional indicators of furniture system demand remained strong, those indicators did not translate into end demand for Steelcase's products.

In 1999, just as the company's profitability started to weaken, Steelcase purchased the remaining 50 percent of Strafor, a previous joint venture interest in Europe and Africa with annual sales of $500 million. Because the two companies concentrated on different aspects of the furniture business, the addition of Strafor's business to the balance sheet had a material effect on several of Steelcase's financial ratios. All of Steelcase's products were "made to order." This business model had allowed it to carry only a small amount of inventory, and Steelcase's dealers typically paid for purchases in less than 30 days. Strafor did not have the same inventory constraints. Also, many of Strafor's customers were accustomed to paying closer to 90 days after receiving an order. With the Strafor acquisition, inventory at Steelcase rose and inventory turnover fell.

At the same time, however, a new customer base increased Steelcase's collection risk. The softness in the balance sheet reinforced investor concerns over deteriorating earnings performance.

Steelcase performance in 1999–2000 was mediocre. Sales slumped or, at best, remained flat. Cost control initiatives and a cut in bonuses brought earnings up in 1999, but gains were erased by a significant fall in earnings reported in 2000.[7] Steelcase had expected a certain amount of business in 1999 that never materialized, throwing off the company's cost structure and causing the gross margins to drop.

Sagging sales turned into a flood of orders in early 2000, coming in from companies that had delayed renovation projects until after Y2K. Investors expected Steelcase to bounce back quickly. Unfortunately, the company had underestimated the costs associated with serving a rush of new orders. According to Grueber, "As the surge in business came in 2000, when our system should have been there to meet the needs without any difficulty, the customer service requirements were so rigorous in terms of delivering product, getting it there on time, and the pricing environment so tough that we had further erosion of our gross margins and operating margins." Profitability and operating margins continued to slump.

At the time of the IPO, Steelcase had no debt on its balance sheet. It had positive earnings of $1.40 per share (including shares issued through the IPO) and an overall strong demand for its product. Two years later, Steelcase faced increasing volatility in end demand and a weaker balance sheet. The company was unsure of what strategy to communicate to investors. "The market just didn't understand what was happening," said Grueber, "and we were not in a position to articulate a great strategy."

[7] Note that Steelcase operates on a fiscal year ending in February, and all references to financial statements are for the year ending in February.

THE INVESTOR RELATIONS EFFORT (1998–2000)

STRUCTURE

Because of its large size and market-leading position, Steelcase had the potential to be a credible, attractive investment for multiple types of institutional investors. But institutions didn't flock to Steelcase shares. The company was large enough to be included on several indices; however, its percentage weighting was often adjusted to reflect its small float (the number of shares owned by the public, not including insiders). Many institutional investors chose to steer clear because of its relative illiquidity. SEC filings showed only 28 institutional holders of Steelcase in 2000, representing between 5 and 8 percent of the shares available to the public. With the exception of several small index players, turnover among institutions was well over 50 percent, meaning that the institutional shareholder base changed every two years.

When Perry Grueber arrived at the company to take over as Director of Investor Relations, he replaced Gary Malburg, who was both the Vice President of Finance and Treasurer and Head of IR. Malburg had been responsible for communicating with investors, answering questions, and assisting with the financial statements. However, because of significant and growing responsibilities in the Treasury department, only about a quarter of his time was available for investor relations activities. The company's Corporate Communications Director, Allan Smith—who reported to the Vice President of Global Marketing and Communications, Georgia Everse—also assisted the IR effort, crafting and disseminating press releases and creating the company's annual report. The staff in these two divisions had few formal channels for interaction. Steelcase's internal structure lacked a clear conduit for IR staff to respond to the concerns of its shareholders.

Although IR had not been a priority at Steelcase, the company had not remained inactive in its attempts to communicate with existing shareholders following its IPO. It engaged the services of Genesis, Inc., a highly respected investor relations consulting company. According to Deborah Kelly, a partner at Genesis, "The good news was that Steelcase was widely respected by its core constituencies as the dominant force in the office furniture industry and as being guided by people with strategic vision and a solid grasp of trends."[8] Nonetheless, she continued, "there was frustration among investment analysts regarding performance."

Genesis's main responsibility was advising Steelcase in the creation of the company's annual report. Genesis also helped plan Steelcase's first "analyst day" in November 1999, an event hosted by the company for buy- and sell-side analysts and portfolio managers. Leading up to this "analyst day," Steelcase hired another outside consultant to perform a perception study of investors' opinions about company communications. The report produced from the study, according to Kelly, revealed that "investors were looking for a more proactive IR program that could help them better understand strategic objectives and they wanted to have greater access to management, so they could get more than just the phone answered." Analyst day helped open up the decision-making process to many analysts and portfolio managers, but this important first step lacked the vital follow-up that additional proactive communications might have provided. As he entered the company, Grueber had the opportunity to launch a renewed and sustained effort to implement strong IR strategies at Steelcase.

GUIDANCE AND REPORTING

In some ways, Steelcase resembled a public company even before its IPO in 1998; it had a board of directors, audited financial statements, and a large shareholder base. Once Steelcase became a public company, however, the previous shareholder makeup led to an "inner circle" mentality that proved difficult to change. Management was not used to the additional requests for information and sometimes assumed a defensive posture toward inquisitive analysts or investors. "Once we had come public," said Grueber, "we were providing the required elements but not a great deal of insight into decision making at the company or the strategic direction of the company."

Steelcase's reluctance to share publicly its inner decision-making processes extended a company approach to communications that had developed during its decades of heavy reliance on the controlling families' leadership. The families chose board members as their representatives, who then hired and supervised the management team. The company under this system earned a strong level of trust both in its direction and in the quality of the reported information. Very little information was ever questioned or requested by non–board members. Along with this trust, though, came a highly conservative outlook from company leadership with regard to the amount of information shared and prospective statements regarding business performance.

In each earnings release, Steelcase typically disclosed very specific guidance for the upcoming year or quarter. Grueber noted, "The company, due to its conservative nature, has been very cautious about selective disclosure throughout its public life. The way they communicated to the Street was through a press release." Due to advice from internal counsel and a desire to prevent selective disclosure, management never "walked the Street up or down" with its estimates.[9] Another major

[8] This and all quotes are from interviews with Deborah Kelly in May 2002.

[9] "Walking the street" is a practice that includes providing material information to analysts during conversations, making excessive statements concerning future earnings prospects, or blatantly encouraging analysts to raise a lower earnings estimate. Some of these tactics have since been prohibited through the Regulations for Fair Disclosure, enacted in 2000.

factor in Steelcase's conservative approach to its disclosures after it became public was the lack of incentives to develop a strong quarterly forecasting discipline during its years as a private company. In addition, the company did not strive to build and maintain relationships with its analysts, so when it came time to disseminate information, it didn't have a receptive ear through the sell-side analysts.

Steelcase's inexperience with releasing company information to the analyst community cost it credibility in the years immediately following its IPO. Press releases assumed relatively high importance at Steelcase in a company environment that both lacked a strong channel for adjusting guidance and reflected the company's inherently conservative attitude toward providing information to outside parties. Unfortunately, if the information published in a current press release was inconsistent with earlier guidance, Steelcase could do very little to minimize the surprise the information caused investors. Several pre-announcements in 1998 and 1999 damaged Steelcase's reputation with investors and increased the perceived risks associated with owning the stock. As Genesis's Deborah Kelly explained, "They kept missing quarters and it was an unusually large number. For a company that has just gone public, usually you want to have 4–5 quarters in the bag. . . . Not here."

NEXT STEPS FOR STEELCASE

Overall, Steelcase put a tremendous amount of effort into its IPO and into readying itself for the rigor of being a public company. Unfortunately, assumptions about public company communications that Steelcase made based upon past experiences as a private company often led to disappointment for investors. In addition, the equity markets entered into an extremely turbulent period after the IPO, which caused significant shocks to equity values and corporate capital spending and also created a harsh environment for a newly public company to develop its investor relations acumen. Deborah Kelly summed up Steelcase's situation as follows:

> I think they put a lot of effort into getting a grasp for what being a public company meant from a communications perspective. They are such good people. They are a terrific management team in terms of doing the right thing, integrity, and caring about what happens. The shock was that they had spent so many years communicating with owners that I don't think they realized there might be a difference when you go public. It was kind of a shock that you had to do things a little differently and have a different sensitivity with this group.

As part of Steelcase's effort to readdress its corporate communication to investors, the company had hired Grueber, and now it was up to him to outline his goals and strategy for the IR department.

CASE QUESTIONS

1. As part of creating the full-time IR position, Steelcase had to decide where to place Grueber in the company hierarchy. Given the issues facing Steelcase when Grueber arrived, what are the strengths and weaknesses of placing Grueber under the CFO versus the corporate communications department?
2. What resources should Grueber ask for? How should he organize the function (reporting lines, internal staff versus agencies, etc.)?
3. What investor constituencies should Steelcase try to interest in the company's stock? What channels should Grueber use to attract them? What message would Steelcase deliver to them?
4. What mistakes did Steelcase make in its past IR efforts?
5. What are the biggest challenges facing Steelcase in mid-2000 and beyond? How would you position the IR function to handle those challenges?
6. What can you learn about Steelcase today through an online search of its website?

CHAPTER NINE

Government Relations

Government and business in the United States tend to have an adversarial relationship, as business attempts to minimize government involvement in the private sector and Washington attempts to manage the needs of all citizens by exerting its power over the corporate realm.

Government influences business activities primarily through regulation. Originally, government regulation managed market competition. The first government regulations applied to industries such as railroads and telecommunications, in which high barriers to entry facilitated the emergence of monopolies that could hurt the consumer. In these cases, regulation replaced Adam Smith's "invisible hand" to protect citizens from high prices, bad service, and discrimination.

Governmental regulation of monopolies has not prevented large corporations, however, from wielding impressive political and social power. The predominance of global corporate giants such as ExxonMobil, Coca-Cola, Boeing, and Microsoft transcends voting districts and political borders. Some of the most politically active organizations in the United States are, in fact, domestic or multinational corporations and trade associations.[1] Political largesse on the part of big business has made many Americans cynical about the integrity of the political process in Washington and its ability to govern the corporate world properly. The recent activities under the "Occupy Wall Street" umbrella are a good example of this cynicism.

As Chapter 1 has shown, action against particular corporations that the public perceives as corrupt is increasingly prevalent. Anticorporate campaigns range from boycotts and demonstrations that support legislation to restrict corporate influence on Capitol Hill. In the fall of 2008, the near collapse of the financial banking system and the following global credit crisis led Congress to pass a bill in July 2010 that increased government's role in the financial markets. For the first time in nearly a century, the government cracked down on the U.S. banking sector, an industry that historically had been ignored by Congress. When Congress grilled U.S. bank chief executives on how Troubled Asset Relief Program (TARP) money was used, the government appeared to take the protestors' side.

In this chapter, we first examine the nature of the relationship between government and business. Then, we discuss the importance of government relations departments within companies and how the function itself has developed over the past few decades. After seeing how businesses today manage government affairs,

[1] Wendy L. Hansen and Neil J. Mitchell, "Disaggregating and Explaining Corporate Political Activity: Domestic and Foreign Corporations in National Politics," *American Political Science Review*, December 1, 2000, p. 891.